



STATE OF CONNECTICUT
DEPARTMENT OF BANKING

STATE OFFICE BUILDING • HARTFORD, CT 06106



BRIAN J. WOOLF
COMMISSIONER

SECURITIES AND BUSINESS INVESTMENTS DIVISION
BULLETIN

HOWARD B. BROWN
DEPUTY COMMISSIONER

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BANKING COMMISSIONER'S COMMENTS

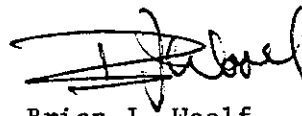
The fourth edition of the Securities Bulletin reflects the continuing effort of the Department of Banking through its Securities and Business Investments Division to combat and deter securities and business opportunity abuses. When warranted, and after appropriate administrative action is taken by this department, civil complaints are referred to the Office of the Attorney General of Connecticut and criminal complaints are referred to the Office of the Chief State's Attorney. When appropriate, cases are referred to the regional offices of the Securities and Exchange Commission and the National Association of Securities Dealers, Inc.

The bulletin also contains an Investor Alert which points out some steps which investors themselves can take to guard against certain risks and pitfalls associated with investments in penny stocks. Based on feedback we have received, the Investor Alert is enhancing our dialogue with the investing public, the securities industry, legal practitioners, and other interested persons.

Included in this edition also is a proposed advisory interpretation on which I have invited comments. The proposed interpretation, among other things, primarily addresses the issue whether certain employees of financial institutions who are engaged in providing securities brokerage services to customers of such institutions, are required to be registered as agents under the Connecticut Uniform Securities Act.

There is also a discussion of the work of the National Conference of Commissioners on Uniform State Laws. I support the objective of the conference to the extent that they may serve as a model for the implementation of coherent, consistent and uniform state securities laws.

We welcome comments on the contents of the bulletin and any other aspect which may prove beneficial to its readers.



Brian J. Woolf
Banking Commissioner

SECURITIES & BUSINESS INVESTMENTS DIVISION
DEPARTMENT OF BANKING
ANNOUNCEMENTS

Advisory Committee to the Banking Commissioner
on the Connecticut Uniform Securities Act

On March 5, 1984, Frank J. Marco, Esq. a partner in the law firm of Shipman & Goodwin, 799 Main Street, Hartford, CT, was appointed to the Advisory Committee. Attorney Marco has had substantial experience representing major investment bankers, privately held corporations (both as in-house and as outside counsel) and publicly traded corporations of various sizes.

On July 12, 1984, Richard Slavin, Esq., associated with the law firm of Cohen and Wolf, P. C., 1115 Broad Street, Bridgeport, CT, was appointed to the Advisory Committee. Attorney Slavin was formerly employed with the Department of Banking as Director of the Securities and Business Investments Division.

North American Securities Administrators Association, Inc.
Committee Assignments

Ralph A. Lambiase, Vice Chairman, Broker Dealer Oversight Committee
Maryellen Meara, Forms Revision Committee
Eric Wilder, Investment Advisers Committee
Sidney Igdalsky, Zone Coordinator, Enforcement Coordination and Information Committee (Northeast Zone)
Calèb Nichols, Chairman, Disclosure Standards Committee
Cynthia Antanaitis, Regulation of Financial Planners Study Committee

Personnel Changes

On July 11, 1984 Eric J. Wilder was promoted from Principal Examiner to Assistant Director of the Securities and Business Investments Division. Mr. Wilder oversees the broker-dealer and investment adviser registration section and the securities and business opportunity registration section.

On July 20, 1984 Margot T. O'Grady was promoted from Examiner II to Banking Examiner III (Securities).

On August 17, 1984 Norma Heckendorf was promoted from Examiner II to Banking Examiner III (Securities).

On September 17, 1984 Virginia C. Hughes resigned from the position of Principal Examiner of the Enforcement/Examination Section of the Securities and Business Investments Division.

On September 28, 1984 June Christensen was promoted from Clerical Trainee to Clerk.

On September 28, 1984 Tia Damato was promoted from Head Clerk to the position of Connecticut Career Trainee.

On October 11, 1984 Paula J. Boivin resigned from the position of Connecticut Career Trainee. Ms. Boivin accepted a position with the Department of Revenue Services of the State of Connecticut.

On October 19, 1984 Jean Foto was promoted from Head Clerk to Clerical Unit Supervisor of the securities and business opportunity registration section of the division.

TEMPORARY AGENT TRANSFER PROGRAM

On July 5, 1984 the Banking Commissioner issued an Order pursuant to Section 36-500(e) of the Connecticut Uniform Securities Act and Section 36-500-32(a)(6) of the Regulations of Connecticut State Agencies would enable Connecticut to join the vast majority of states participating in the NASAA/CRD Temporary Agent Transfer Program. The Temporary Agent Transfer Program would expedite and facilitate the transfer of agents from one broker-dealer to another in this state. In the past, the transfer of broker-dealer agents had been hindered due to the failure of terminating broker-dealers to timely file a notice with the Commissioner on Form U-5. The Temporary Agent Transfer Program would provide for a temporary transfer of registration for agents who terminated employment with a terminating broker-dealer within the previous seven calendar days and without disciplinary reasons.

The Temporary Agent Transfer Program would be implemented through the Central Registration Depository system ("CRD"), which is operated by the National Association of Securities Dealers Automated Quotation System ("NASDAQ"), a wholly owned subsidiary of the National Association of Securities Dealers ("NASD"), under a contract with the North American Securities Administrators Association, Inc. ("NASAA"), on behalf of NASAA's state regulatory jurisdictions. Connecticut is a member of NASAA. To participate in the Temporary Agent Transfer Program, a broker-dealer would have to execute and file with the Commissioner, through the CRD, a broker-dealer undertaking and maintain sufficient funds on deposit with the CRD to pay the required regulatory fees. The Temporary Agent Transfer Program would enable a broker-dealer agent to be temporarily transferred to a participating broker-dealer for a 21-day period. The registration would then be made permanent if a properly executed Form U-4 were filed on behalf of the agent. The temporary transfer of registration for agents would not relieve a terminating broker-dealer from filing a Form U-5 within five days of termination of employment. In addition, the temporary agent transfer would not relieve any employing broker-dealer or its agents of liability imposed under the Connecticut Uniform Securities Act or its regulations or of any liability imposed at law or in equity. The Temporary Agent Transfer Program would be particularly beneficial in Connecticut, which ranks fifth or sixth nationwide in the number of registered agents. The Temporary Agent Transfer Program is expected to ease the transfer of broker-dealer agents, alleviate the hardship to agents from a terminating broker-dealer's delinquency in filing Form U-5, and provide a procedure for agent transfer that is uniform with other states.



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Proposed Advisory Interpretation

Summary

Financial institution involvement in securities-related activities and the desire of traditional securities firms to become involved in banking reflects a drive for diversification of activity in the financial services industry. The need to realize greater profits and expand customer base in an uncertain economy has fostered diversification. Diversification has assumed two basic forms: 1) Geographical expansion and 2) product diversification. Financial institutions, for example, have expanded their activities through separate subsidiaries and affiliates; acquired other related business entities and contracted with concerns which would directly or indirectly allow for greater product diversification. As the line between traditional "banking" and traditional "securities" activities becomes blurred, a functional analysis of banking and securities activity becomes necessary.

The Banking Commissioner of the State of Connecticut is issuing an advisory interpretation pursuant to Section 36-500(e) of Chapter 662 of the Connecticut General Statutes, the Connecticut Uniform Securities Act (the "Act"). The interpretation uses a functional approach in applying the definition of "agent" contained in Section 36-471(b) of the Act to certain employees of financial institutions which have entered into contractual arrangements with broker-dealers to enable those financial institutions to provide securities brokerage services to their customers. The interpretation also provides that a broker-dealer occupying physical space within a financial institution will be deemed to be operating a "branch office" as defined in Section 36-500-13(a)(4) of the Regulations promulgated under the Act. In addition, the interpretation prescribes certain requirements for the advertising of securities services and the segregation of records. The interpretation also bars broker-dealers participating in contractual arrangements with financial institutions from effecting transactions in securities for the fiduciary accounts of those financial institutions.

Date: Comments must be received by October 19, 1984. Comments should be addressed to Caleb L. Nichols, Division Director, Securities and Business Investments Division, Department of Banking, Room 229, 165 Capitol Avenue, Hartford, Connecticut 06106.

Text of Advisory Interpretation

The Banking Commissioner of the State of Connecticut has received several inquiries concerning the applicability of Chapter 662 of the Connecticut General Statutes, the Connecticut Uniform Securities Act (the "Act") to the activities of broker-dealers proposing to enter into contractual arrangements with state bank and trust companies, national banking associations, savings banks, state and federally chartered savings and loan associations or state or federally chartered credit unions located in Connecticut. Pursuant to the terms of the typical contractual agreement, the broker-dealer would be obligated to execute transactions for customers of the financial institution in return for which the institution would be compensated.

Any broker-dealer participating in such an arrangement would be "transact[ing] business in this state as a broker-dealer" within the meaning of Section 36-474(a) of the Act and thus subject to the general supervision of the Banking Commissioner and the registration requirements of the Act and the Regulations promulgated thereunder, including the requirement in Section 36-500-5(b)(1) of the Regulations providing that "[n]o broker-dealer which is a corporation or partnership shall be registered as such without the registration of at least one agent...." No broker-dealer will be excused from the registration requirements of Section 36-474(a) of the Act because such broker-dealer only maintains a telephone or telecommunications network between the participating financial institution and the broker-dealer.

The participating financial institution, however, would be excluded from the definition of "broker-dealer" contained in Section 36-471(c) of the Act. Section 36-471(c)(3) of the Act provides an exclusion from the definition of "broker-dealer" for "a state bank and trust company, a national banking association, a mutual savings bank, a savings and loan association, a federal savings and loan association, a credit union, a federal credit union, or trust company."

Section 36-471(b) of the Act defines the term "agent" to mean "any individual, other than a broker-dealer, who represents a broker-dealer...in effecting or attempting to effect purchases or sales of securities." Section 36-474(a) of the Act states, in part, that "[n]o broker-dealer...shall employ an agent unless such agent is registered under...[the Act]."

Notwithstanding the existence of any formal employment arrangement with the participating financial institution, the broker-dealer or both, individuals will be deemed to be representing a broker-dealer in effecting or attempting to effect purchases or sales of securities within the meaning of Section 36-471(b) of the Act and be subject to the registration requirement contained in Section 36-474(a) of the Act if the individual performs one or more of the following functions:

- a) Opens customer accounts and/or makes suitability determinations regarding the purchase or sale of securities. This function, however, will not cover individuals who merely collect or verify information for transmittal to and action by another person registered as an agent or a broker-dealer under the Act.
- b) Renders investment advice or makes investment recommendations in connection with the purchase or sale of securities.
- c) Solicits or accepts orders to purchase or sell securities.
- d) Processes orders to purchase or sell securities.
- e) Handles inquiries or engages in the resolution of complaints regarding the purchase or sale of securities.
- f) Supervises sales personnel either directly or indirectly or assumes responsibility for the day-to-day operation and supervision of any place of business of a broker-dealer in this state.

The Banking Commissioner, however, will not deem any individual who merely engages in the performance of clerical or ministerial functions an "agent" within the meaning of Section 36-471(b) of the Act. An individual who falls within the scope of the definition of "agent" will be subject to all provisions of the Act and Regulations thereunder, including, but not limited to, examination requirements and on-site supervision by the broker-dealer whom the agent represents.

Section 36-500-13(a)(4) of the Regulations defines the term "branch office" to mean "any office, other than a main office but including a corporate subsidiary of the broker-dealer..., which is located in this state, owned or controlled by the broker-dealer...and engaged in the securities or investment advisory business." If a broker-dealer occupies physical space in an area within a financial institution, whether through a lease arrangement with the financial institution or otherwise, and that physical space is directly accessible to customers of the financial institution, the broker-dealer will be deemed

to be operating a "branch office" within the meaning of Section 36-500-13(a)(4) of the Regulations and will be subject to the record keeping and supervisory requirements contained in Section 36-500-13(a) of the Regulations. To facilitate examinations of such branch office by the Department of Banking, each area occupied by a broker-dealer must be sufficiently separated from the retail area of the participating financial institution such that a referred customer may leave the retail area and then choose whether to conduct securities business with the participating broker-dealer without feeling obligated to do so in the presence of officers and employees of the financial institution. In addition, the area must be conspicuously identified as the place of business of the broker-dealer; readily distinguishable from the operations of the surrounding financial institution and staffed by persons whose affiliation with the broker-dealer is conspicuously identified.

The Commissioner may deem it a dishonest or unethical business practice within the meaning of Section 36-484(a)(2)(H) of the Act, resulting in the possible denial, suspension or revocation of an application for broker-dealer registration, if a broker-dealer entering into a contractual arrangement with a financial institution fails, in any prospectus, pamphlet, circular, form letter, form, sign, advertisement or other sales literature or advertising communication addressed or intended for distribution to prospective investors, to accurately represent the role of the participating financial institution; to indicate that the participating financial institution is not a registered broker-dealer under the Act and to indicate that the participating financial institution's existence and activities are separate from those of the participating broker-dealer. Any such material should be filed with the Banking Commissioner by the broker-dealer and will become a part of the registration application or renewal thereof of the broker-dealer.

The Commissioner may also deem it a dishonest or unethical business practice within the meaning of Section 36-484(a)(2)(H) of the Act if a broker-dealer entering into a contractual arrangement with a financial institution effects transactions in securities for the fiduciary accounts of the participating financial institution, unless full disclosure is made to the fiduciary customer of the relationship between the broker-dealer and the participating financial institution.

In addition, the Commissioner may deem it a dishonest or unethical business practice within the meaning of Section 36-484(a)(2)(H) of the Act if a broker-dealer entering into a contractual arrangement with a financial institution fails to keep its books and records separate from those of the participating financial institution.

Issued: October 5, 1984.

Brian J. Woolf
Banking Commissioner

INVESTOR ALERT ON PENNY STOCKS

The Investor Alert is a quarterly program jointly sponsored by the Council of Better Business Bureaus, ("CBBB") and the North American Securities Administrators Association, Inc., ("NASAA"), to expose investment frauds to the public and provide useful information on how to avoid the often sophisticated and unlawful schemes that prey on investors. In a recent release, the CBBB and NASAA issued to investors some cautionary notes on the investment risks involved in penny stocks.

So-called "penny stocks," which are traded generally at very low prices and promote new untested products such as electronic asparagus cutters or gold mining operations, are a growing problem for investors. The penny stock game has the same allure to speculative investors as casino gambling. But sometimes it is fixed. It is filled with unproven or nonexistent products, novice management and investors who don't seem to know or care that a "gold mining property" is under a lake, as long as they are told that their nickel stock in it will go to three dollars a share.

Penny stock losses have mounted to hundreds of millions of dollars in recent years. State securities regulators have taken scores of actions against dealers for violations of state laws. Similarly, Canada Provinces have been active in enforcing securities laws to curb various kinds of investment abuses. Forty five percent of 78 new penny stock issues recently surveyed by Venture magazine had participants who were convicted felons, securities violators, targets of securities investigations, reputed criminal figures or principals who faced serious charges of insider financial misdealing.

HOW PENNY STOCK FRAUDS OPERATE

In the classic penny stock fraud, promoters assign themselves millions of shares of stock at a fraction of a cent per share, or no cost to them at all. Next a prospectus is prepared disclosing that the product has little or no chance of success and the stock is offered at five or ten cents a share. The market is then artificially inflated through demand created by the controlling broker who uses pushy, high-pressure tactics to lure investors.

A broker may not allow an investor "in" unless there is a promise to buy more shares later in order to keep the price up. After the share prices reach several dollars the "smart money" gets out and the stock plummets. Novices often don't realize what is happening and cannot sell in time. After the stock plunges, the company goes out of business, with promoters lining their pockets with the stock proceeds in the company treasury. In this situation, most of the investors will lose a substantial portion, if not all, of their money.

This classic example is not true in all cases of low priced stocks, but it has been seen numerous times. There are, of course, legitimate companies whose securities are traded at low prices, but discriminating between a legitimate offering and penny stock fraud can sometimes be difficult.

